a $100 wholly taxable bond for $112, callable at any time thereafter upon 30 days' notice. The premium of $12 attributable to such bond may be amortized only with reference to the maturity date of the bond. Similarly, assume that in 1957 the taxpayer acquired a $100, 20-year bond, issued on January 1, 1954, for $115. The bond was callable 2 years after the date of issuance or, if not then called, 10 years after the date of issuance. The premium of $15 attributable to such bond may be amortized only with reference to the maturity date of the bond.

Example 2. On January 1, 1958, the taxpayer (who is on a calendar year basis) pays $1,200 for a $1,000 wholly taxable bond which matures on December 31, 1977. The bond is callable on January 1, 1963, at $1,165. The premium computed with reference to the maturity date of the bond is $200. The premium computed with reference to the earlier call date is $35. Although the premium amortized ratably to maturity would yield a deduction of $10 for each year ($200 divided by 20 years), under section 171(b)(1)(B)(ii) the deduction for each taxable year for the period before January 1, 1963, will be $7 ($35 divided by 5 years). If the bond is not called, the deduction for each taxable year in the period from 1963 through 1977 will be $11 ($165 divided by 15 years). If the earliest call date in this example had been January 1, 1961, instead of January 1, 1963, the premium amortized ratably to maturity would be used to obtain a deduction of $10 per year since this would be less than the premium amortized ratably to earlier call date of $11.67 ($35 divided by 3, the number of years to the earliest call date).

(iii) In the case of a wholly taxable bond described in section 171(b)(1)(B)(ii) or (iii), which has a call date, the amount of bond premium attributable to the taxable year in which the bond is called shall include an amount equal to the excess of the adjusted basis (for determining loss on sale or exchange) of such bond as of the beginning of the taxable year over the amount received on redemption of the bond or (if greater than the amount received on redemption) the amount payable on maturity. For adjustments proper to reflect unamortized bond premium for the period before the date as of which section 171 becomes applicable to the bond in the hands of the taxpayer, see subparagraph (4) of this paragraph. For example, if a wholly taxable bond, issued on January 1, 1954, and acquired by the taxpayer on January 1, 1955, at a price of $109, matures in 10 years from the date of issue (9 years from the date of acquisition) but is callable at $105 on 30 days' notice, section 171(b)(1)(B)(iii) requires that the bond be amortized to maturity, that is, at the rate of $1 per year. If the bond is called on December 31, 1956, for $105, then $3, the excess of the adjusted basis of $108 ($109 less $1 deducted in 1955) over the amount received on redemption, $105, may be deducted for the year 1956.

(3) Whether the purchase and immediate transfer of callable bonds occurs in such a manner as to make the entire transaction not bona fide, and hence the deductions for amortization for bond premium not allowable, will depend on all the facts and circumstances.

(4) If the date as of which the basis of the bond was established precedes the first taxable year with respect to which section 171 applies to the bond, proper adjustments shall be made to reflect unamortized bond premium on such bond for the period including the holding period (as determined under section 1223) before the date as of which section 171 first becomes applicable to the bond in the hands of the taxpayer. Such adjustment is required whether an election was made under section 125 of the Internal Revenue Code of 1939 or under section 171 and applies to all bonds to which section 171 is applicable.

(5) The rule relating to adjustments set forth in subparagraph (4) of this paragraph may be illustrated by the following examples:

Example 1. On January 1, 1956, T, who makes his income tax returns on the calendar year basis, owns a fully taxable $100 bond, maturing on January 1, 1966. T purchased this bond on January 1, 1946, for $120. T elects to have section 171 apply to such bond for 1957 and subsequent taxable years. In determining the amount of bond premium to be amortized over the remaining 9 years of the life of the bond, T is required, but solely for such purpose, to treat the bond as if he had amortized the bond premium thereon during the prior 11 years, and to make the proper adjustment in the original bond premium. Accordingly, T would treat $11 as having been amortized during the first 11 years and would be required to amortize the remaining $9 over the following 9 years. When the bond is redeemed on January 1, 1966, for $100, only the $9 attributable to the last 9 years will actually have been amortized and the basis of the bond will have been reduced only by that amount. The $11 attributable to the first 11 years will have been treated as an adjustment to the original bond premium but will not have been amortized nor will the basis of the bond have been reduced by that amount. Consequently, T will have a capital loss in the year of redemption on account of the $11 attributable to the period January 1, 1946, to January 1, 1957.

Example 2. On January 1, 1956, X's father gave him a fully taxable $100 bond maturing on January 1, 1966. X's father had purchased the bond on January 1, 1946, for $120. The fair market value of the bond at the time of the gift was $127. X makes his income tax returns on the calendar year basis and elects to amortize the bond premium on the bond during the period 1956– 1966. Under section 1015, the cost of the bond to X's father constitutes the basis of the bond in X's hands for determining loss, since such cost is lower than the fair market value of the bond at the time of the gift, and, under section 1223, X's holding period is deemed to include the 10 years during which his father held the bond. X is required to treat the bond as if the bond premium thereon had been amortized during his father's holding period. Thus, X is required to amortize $10 over the period January 1, 1956, to January 1, 1966, and in the year of redemption will have a capital loss on account of the $10 attributable to his father's holding period.

Example 3. Y, who makes his income tax returns on the calendar year basis, owns a fully tax-exempt $100 bond maturing on January 1, 1961. He purchased this bond on January 1, 1941, for $120. On December 31, 1954, Y sells the bond for $108 and realizes a gain of $1, computed as follows:

(i) Total bond premium ($120—$100)	$20
(ii) Amount of bond premium amortizable if held to maturity (total bond premium minus unamortized bond premium attributable to 1941 (a year to which section 125 of the Internal Revenue Code of 1939 was not applicable), $20—$1)	19
(iii) Amount of bond premium amortized from Jan. 1, 1942, through Dec. 31, 1954 ($1 for each such year)	13
(iv) Adjusted basis of bond at close of 1954 ($120 – $13)	107
(v) Gains ($108 – $107)	1

(6) Amortizable bond premium on any bond to which section 171 applies is that part of the bond premium on the bond which is attributable to the taxable year.

(b) *Callable bonds.* (1) For purposes of section 171, in the case of a callable bond, the earlier call date will be considered as the maturity date, except as provided in paragraph (a) (2) and (3) of this section. The amount due on the earlier call date will be considered as the amount payable on maturity unless it is determined under a different method of amortization regularly employed by the taxpayer that another amount shall be the amount payable on maturity. Hence, in the case where a bond premium is to be amortized to the earlier call date, the bond premium on such bond is required to be spread over the period from the date as of which the basis for loss of the bond is established down to the earlier call date, rather than to the maturity date. The earlier call date may be the earliest call date specified in the bond as a day certain, the earliest interest payment date if the bond is callable at such date, the earliest date at which the bond is callable at par, or such other call date, prior to maturity, specified in the bond as may be selected by the taxpayer.

(2) Where a deduction for amortizable bond premium may be determined with respect to alternative call dates, the amount of amortizable bond premium calculated with reference to a particular call date must be calculated thereafter with reference to the same call date. However, if, upon such call date originally selected, the bond has not in fact been called, the bond premium then unamortized must be amortized to a succeeding call date or to maturity. Thus, assume a $100 bond is acquired at time of issue for $125. The bond is callable in five years at $115 and in 10 years at $110. The taxpayer may amortize $10 of premium during the first five years and, if the bond is not then called, an additional $5 of premium during the next five years. If the bond is not called at the end of ten years, the remaining $10 of premium must be amortized to maturity.

(c) *Convertible bonds.* (1) The fact that a bond is convertible into stock does not, in itself, prevent the application of section 171. A convertible bond is within the scope of such section if the option to convert on a date certain specified in the bond rests with the holder thereof. However, for the purpose of determining the amount of amortizable bond premium on a convertible bond for the taxable year, the amount of bond premium shall not include any